



Independent Reserve  
Level 26, 44 Market Street, Sydney NSW 2000  
[www.independentreserve.com](http://www.independentreserve.com)

**Director – Crypto Policy Unit  
Financial System Division  
The Treasury**

Langton Crescent  
Parkes ACT 2600  
[crypto@treasury.gov.au](mailto:crypto@treasury.gov.au)

**Dear Director,**

Thank you for providing us with the opportunity to provide feedback on the Token Mapping Consultation Paper February 2023 (Consultation Paper).

We welcome the Government's sentiments in the Consultation Paper that it is committed to improving the way Australia's regulatory system manages crypto assets, and we also welcome the focus on the Government seeking to provide greater protections for consumers.

Independent Reserve Pty Ltd ([Independent Reserve](https://www.independentreserve.com)) is a Digital Currency Exchange (DCE) that has been operating in Australia since 2013 and for many years has been a proponent of regulation in the digital asset and cryptocurrency sector. We have in the past worked with AUSTRAC on the development of the AML/CTF framework for DCEs and were active contributors to all initiatives and consultation papers issued by the Government in the past two years.

Independent Reserve services hundreds of thousands of Australian customers each year. In the financial year ending 2022, Independent Reserve's total turnover on its platform exceeded AUD\$5 billion; and total assets in custody are in the hundreds of millions of dollars. We take the responsibility of handling and holding large customer assets very seriously and we welcome the focus on regulation in this industry to provide certainty for service providers such as Independent Reserve and to enhance consumer protection mechanisms.



We support the implementation of common-sense legislation that addresses what we believe are the three most critical issues facing the industry:

1. Providing real protection for Australian consumers by requiring a licensed custody provider to be located in Australia
2. Minimum standards for all crypto service providers in the crypto asset space
3. A licensing regime that enables sensible classification of crypto tokens that paves the way for a comprehensive licensing regime

A handwritten signature in purple ink, consisting of a stylized 'O' followed by a checkmark-like flourish.

# Responses to Consultation Questions

## Part A - Background

### ***Q1) What do you think the role of the Government should be in the regulation of the crypto ecosystem?***

We believe the Government should introduce legislation that regulates the crypto industry. The introduced legislation should achieve three main objectives:

1. Put in place consumer protection mechanisms that cover, at a minimum:
  - a. Asset management and custody
  - b. Segregation of customer and operational assets, including Trust account requirements
  - c. Adequate declarations and risk disclosures to be provided to customers by crypto service providers
  - d. Fit and proper test for individuals owning and running companies in the crypto industry
  - e. Businesses that handle customer assets to be well-capitalised
  - f. Domicile of the crypto service provider
2. Ensuring Australia is an attractive place to open and run a crypto service business. The jurisdiction-free nature of the underlying assets means that if the industry is over-regulated in Australia, customers and businesses will simply use offshore service providers. Regulation should encourage local and overseas businesses to open offices in Australia, invest in the crypto industry in Australia and by extension, employ more Australians and make Australia a global crypto hub.
3. Ensuring the legislation is introduced in a way that provides sufficient segregation from the 'traditional' financial services covered by the Corporations Act. The jurisdiction-free and general absence of a central body controlling each crypto token means that many elements of the current regulatory regime are simply not possible to comply with.  
For example: a market operator in Australia listing Bitcoin being subject to continuous disclosure obligations. There are no owners of Bitcoin, no holders of unique, sensitive information and no representatives who would be responsible for making the disclosures to each of the market operators. In this case, what listing rules and insider trading rules would be relevant and apply?

***Q2) What are your views on potential safeguards for consumers and investors?***

Customers expect their assets to be handled in a safe and secure manner, and stored in an environment with robust, regularly tested controls. We firmly believe that customers should be able to trust that their crypto service provider is treating their assets appropriately and that they are safe and will be delivered to the customer as and when requested, without exception.

In addition to the customer protection measures mentioned in question 1 above, it is critically important that consumers' assets are held in Australia, by a duly licensed, registered, crypto custodian. In almost all instances of mass-loss events globally, the asset custodian has been domiciled in a less-sophisticated jurisdiction where rights of recourse and director accountability have been low or non-existent. We need look no further than the recent FTX collapse, where the company was incorporated in Antigua and Barbuda and headquartered in the Bahamas. This means that any customer seeking recovery of their funds must either independently, or through a class-action, take legal action across borders and in a foreign domicile where laws may not provide adequate protections for Australians.

Several Australian companies such as Digital Surge outsourced their custody to FTX which then resulted in their customers being caught up in the FTX collapse without ever knowingly agreeing to being exposed to an offshore custodian.

We have seen arguments put forward by other participants in the Australian crypto sector opposing any on-shore custody requirement. These arguments centre around two major points:

1. Businesses can have a local, responsible person in Australia who has liability for the compliance obligations
2. That the custody industry in Australia is not well-developed.

Regarding point 1: 'FTX Australia' was operating in Australia, it even had an AFSL. In recent media, it was discovered that ASIC had great concerns about how 'FTX Australia' was operating. It turns out these concerns were well-founded as when FTX collapsed, 'FTX Australia' had no segregated customer assets, no claim to those assets and all Australian customers are now left to seek recovery in the Bahamas.

Digital Surge, an Australian-based cryptocurrency exchange used 'FTX Australia' for a large portion of its custody. Digital Surge are based in Australia, with Australian founders and Australian directors, but again, due to the custodian not being subject to local laws regarding custody, reconciliation, reporting etc, the failure of an offshore custodian has again left Australian consumers with no recourse other than seeking recovery through the court system in the Bahamas.

It is clear that simply having a shell entity with a director or responsible person in Australia does very little to protect the assets of Australians.

Regarding point 2: Creating a safe, robust, scalable crypto custody service is not easy. It requires a significant up-front investment and requires the custodian to incur significant ongoing maintenance costs. The easiest way for a crypto service provider to manage customers' crypto assets is to simply outsource the custody to an offshore provider. It is cheaper, easier and requires no ongoing maintenance or work from the crypto service provider. This however exposes its customers to a potential 100% loss scenario as seen with FTX and Digital Surge. If a business is not willing to

prioritise the security of its customers' assets by making the required investment in a robust, secure and scalable local custody solution, then they should not be permitted to provide custodial services and must use the services of a local custodian who is subject to regular scrutiny by Australian regulators and ensures all customer assets are completely separate from any company assets.

It cannot be stressed enough how important it is that a custodian who holds digital assets on behalf of Australian consumers is incorporated in Australia, with Australian directors, Australian operations and is subject to local custodial requirements and licensing to protect Australian consumers' assets.

***Q3) Scams can be difficult for some consumers to identify.***

***a) Are there solutions (e.g. disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?***

Any reputable Australian operator should be aware of the risk of scam activity and their customers potentially being victims of third party scammers and have a range of warning and safeguards in place already. Unfortunately the majority of scam activity that we see involve customers who have been coerced by a third party to undertake certain transactions. Detection and prevention is difficult as customers are seemingly willing participants until they realise many months later they have been victims of a scam.

Reputable businesses should have in place baseline level warnings and other detection mechanisms in place to try and minimise the prevalence and impact of the activities of third-party scammers. This could be covered in a code of practice rather than legislative reform.

***b) What policy or regulatory levers could be used to ensure crypto token exchanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?***

In addition to the comments in part a) above, policy should require businesses to undertake a due diligence process for each digital token prior to offering any crypto-related services for that token. This will then exclude outright scam tokens and tokens with very poor backing and fundamentals that would expose customers to excessive risk of total loss.

This response is written under the assumption that privacy tokens and tokens that are clearly financial products are prohibited and covered under existing legislation respectively.

## Part B - Token mapping: terminology and concepts

### Crypto Networks

***Q4) The concept of ‘exclusive use or control’ of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records.***

***a) How do you think the concepts could be used in a general definition of crypto token and crypto network for the purposes of future legislation?***

From a legislative standpoint, it is necessary to segregate crypto tokens from other digital records. This is critical in setting up legislation that is targeted to where it is needed (the crypto industry) and will not inadvertently impact other businesses and industries that house digital data and records (such as a bank, custodian, or share registry)

A careful consideration to the wording of the definition will be critical in enabling the legislation to be impactful where it is needed.

***b) What are the benefits and disadvantages of adopting this approach to define crypto tokens and crypto networks?***

The advantages of this approach were broadly covered in our response to part a) above. A potential disadvantage is that any definition may be too restrictive and exclude some crypto assets. We believe this can be resolved through adequate consultation between Government and crypto industry participants in Australia.

### Taxonomy

***Q5) This paper sets out some reasons for why a bespoke ‘crypto asset’ taxonomy may have minimal regulatory value.***

***a) What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?***

One of the key issues with using the existing *functional perimeter* to define crypto assets is the reliance on every crypto asset being a “Financial product”. The existing definition of financial products are functional and effective, however have not managed to successfully capture crypto assets neatly. The issues with simply classifying every crypto asset as a Financial Product under existing definitions are many, and beyond the scope of the response to this question.

We support the creation of a bespoke crypto asset taxonomy.

***b) What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?***

We are in support of this approach. As alluded to in our response to part a) above, there are many elements of the current regulatory regime that may be inappropriate requirements (and often impossible to comply with) that would be imposed on crypto assets. Some examples of this are:

- Markets licence to offer trading in crypto assets
  - unlike ASX and others, there are thousands of points of independent price discovery globally, to what extent could market controls be imposed on a 'market provider'
  - Continuous disclosure when no entity or person 'owns' the asset
  - Listing rules, who and how would they be applied
- Trading and custodial services
  - How would a PDS be drafted where there is no central, controlling entity to provide information about the underlying 'product'
  - Would there be a separate PDS for every 'class' or type of crypto asset?
- There is no central clearing for any crypto assets

We support the creation of a standalone regulatory framework that utilises the bespoke taxonomy. In our view, there are ways of implementing this as an addendum to the existing legislation, using new AFS licence conditions specific to crypto assets and new crypto-specific asset classes.

***c) In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non-financial manner?***

We do not believe the existing regulatory environment is suitable for managing the crypto assets.

## **Part C - Intermediated token systems**

***Q6) Some intermediated crypto assets are 'backed' by existing items, goods, or assets. These crypto assets can be broadly described as 'wrapped' real world assets.***

***a) Are reforms necessary to ensure a wrapped real-world asset gets the same regulatory treatment as that of the asset backing it?***

In instances where it means the crypto asset appears to exist simply to circumvent the existing regulatory regime, yes.

***Why?***

If a 'backed' or 'wrapped' asset exhibits the characteristics of the financial product underlying it or gives the same rights as holding the asset underlying it, then it should not be excluded from the existing regulatory regime.

***What reforms are needed?***

For 'backed' or 'wrapped' assets that are not financial products, there needs to be a protection in place for the consumer that ensures the asset (whatever it may be) is set aside by the token issuer so it can at all times be redeemed or delivered to the holder of the crypto asset

***b) Are reforms necessary to ensure issuers of wrapped real-world assets can meet their obligations to redeem the relevant crypto tokens for the underlying good, product, or asset?***

Yes. Assets subject to any claim by the holders of a crypto token should be held on behalf of the holders of the crypto token.

***Q7) It can be difficult to identify the arrangements that constitute an intermediated token system.***

***a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens?***

We do not support this. This puts the obligation on a service provider to undertake due diligence on a token on behalf of the customer and sets up the customer as being in part, or wholly, reliant on the service provider for the information on the token. This then conveys duty of care, liability, etc.

Service providers should identify the risks of the class of tokens in the standard disclosures required and let the consumers decide where they invest their funds. This is how many other financial products operate and crypto assets should be the same.

***How might this be achieved?***

As per our response above, it is not practical, or desirable to have this arrangement in place.

***b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?***

Please refer to our response to question 3a

***Q8) In addition to the functional perimeter, the Corporations Act lists specific products that are financial products. The inclusion of specific financial products is intended to both: (i) provide guidance on the functional perimeter; (ii) add products that do not fall within the general financial functions.***

***a) Are there any kinds of intermediated crypto assets that ought to be specifically defined as financial products?***

As a broad classification, no.



**Why?**

As far as we are aware, there is not an entire class or type of crypto assets that should immediately be classified as financial products. Wrapped crypto assets are not necessarily financial products, it depends on the underlying asset, the rights, income streams, etc. These can and should be dealt with on a case-by-case basis by the service providers in their initial due diligence in offering services supporting the crypto asset.

***b) Are there any kinds of crypto asset services that ought to be specifically defined as financial products?***

Yes.

**Why?**

There are crypto assets that meet the current definition of financial products. These are not entire classes or types of crypto assets, rather individual, specialised examples. These products should not be exempt from the existing regulatory regime because they operate using crypto technology.

***Q9) Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?***

We do not believe the legislation should reach down into the details of specific networks. They change too rapidly and new networks can also appear quickly. Due diligence guidelines for service providers, safe storage of assets, consumer protections, disclosures, and other measures should be sufficient without legislatively restricting crypto tokens to specific networks (thereby creating a government-endorsed network, which is not desirable)

***Q10) Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework?***

No

**Why?**

As per our response to question 7a, service providers should direct consumers to potential risks of the product or class of tokens in the standard disclosures required and let the consumers decide where they invest their funds. This is how many other financial products operate and crypto assets should be the same.

## Part D - Public token systems

Q11) Some jurisdictions have implemented regulatory frameworks that address the marketing and promotion of products within the crypto ecosystem (including network tokens and public smart contracts). Would a similar solution be suitable for Australia?

No. If the correct regulatory regime is put in place that provides consumers with sufficient warnings about the risks of investing in a class of crypto assets, affords consumers protection for their crypto assets and the services are provided by duly licenced and compliant service providers, why would there be a need for a restriction on advertising a service? Restricting advertising would presume that the regulatory framework is insufficient to protect consumers.

We of course support the existing restrictions on providing advice in any way in advertising. If crypto assets are provided their own taxonomy, asset class and licence conditions, then the existing restrictions on advice and restricting advertising to product information will operate effectively in the crypto asset class.

***If so, how might this be implemented?***

N/A

***Q12) Smart contracts are commonly developed as 'free open-source software'. They are often published and republished by entities other than their original authors.***

***a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?***

No specific comments on this question.

***b) What are the regulatory and policy levers available to ensure smart contract applications comply with existing regulatory frameworks?***

No specific comments on this question.

***Q13) Some smart contract applications assist users to connect to smart contracts that implement a pawn-broker style of collateralised lending (i.e., only recourse in the event of default is the collateral).***

***a) What are the key risk differences between smart-contract and conventional pawn-broker lending?***

***b) Is there quantifiable data on the consumer outcomes in conventional pawn-broker lending compared with user outcomes for analogous services provided through smart contract applications?***

No specific comments on this question.

***Q14) Some smart contract applications assist users to connect to automated market makers (AMM).***

***a) What are the key differences in risk between using an AMM and using the services of a crypto asset exchange?***

***b) Is there quantifiable data on consumer outcomes in trading on conventional crypto asset exchanges compared with user outcomes in trading on AMMs?***

No specific comments on this question.

## Follow Up

We thank the Crypto Policy Unit of the Treasury for the opportunity to participate in the consultation process for the crypto industry in Australia. We have been active contributors for a number of years in all efforts to introduce appropriate crypto legislation in Australia.

We acknowledge the process is not easy and will take a significant period of time to get right and put in place. We are happy to provide further clarification to the Treasury on the content of this response. If the Crypto Policy Unit requires any additional clarifications, feedback or engagement, we are more than happy to assist where we can.

We look forward to the next stage of Treasury's plans for regulation in the crypto industry.

King Regards,

